

Insurance Against Competition: How the McCarran-Ferguson Act Raises Prices and Profits in the Property-Casualty Insurance Industry

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The insurance crisis of the mid-1980s is over, and the insurance cycle has turned, just as it did in 1977 following the crisis of the mid-1970s.¹ Why did insurer profitability bottom out in 1984–85, leading to the dramatic rate increases and the refusals to write insurance that comprised the insurance crisis of 1985–86? In their article, *Sources of the Crisis in Liability Insurance: An Economic Analysis*,² Richard Clarke, Frederick Warren-Boulton, David Smith, and Marilyn Simon (“the authors”) suggest that the expansion of tort law caused the crisis and reject the relevance of the immunity from antitrust prosecution granted to the insurance industry by the McCarran-Ferguson Act.³ The empirical evidence, however, demonstrates the opposite.

In responding to the authors’ contentions, this Comment first argues that the expansion of tort law did not cause insurance rates to rise during 1985–86. Notably, restrictions on tort law have not caused rates to fall, and, according to the industry, they will not do so. Second, the Comment suggests that the McCarran-Ferguson antitrust immunity has been the major cause of the insurance industry’s cyclicity, including its periodic “crises.” This Comment criticizes the authors’ failure to take three issues into account: industry conduct indicating the existence of collusion, evidence that collusive conduct protected by the McCarran-Ferguson Act

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1. The property-casualty insurance industry, which in 1984 and 1985 had its worst two years ever, had its best two years in 1986 and 1987. See INSURANCE SERVS. OFFICE, 1986 INSURER FINANCIAL RESULTS: AN ANALYSIS OF THE STRENGTH OF THE PROPERTY-CASUALTY INDUSTRY’S RECOVERY 5 (1987) [hereinafter ISO REPORT]. In 1987 medical malpractice insurers had their most profitable year since 1979, and general liability insurers had their best year since 1980. See BEST’S INS. MGMT. REP., Release No. 48, at 8–10 (Dec. 28, 1987); *Property-Casualty Insurers Report Dramatic Income Gains*, National Underwriter, Jan. 11, 1988, at 1, col. 1.

2. Clarke, Warren-Boulton, Smith & Simon, *Sources of the Crisis in Liability Insurance: An Economic Analysis*, 5 YALE J. ON REG. 367 (1988).

3. Ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011–1015 (1982 & Supp. III 1985)).

caused the insurance crisis of 1985-86, and the supra-competitive profitability⁴ of general liability and medical malpractice insurance over the long run. It concludes by placing the authors' arguments in historical context.

I. The Effect of Tort Reform on Insurance Rates

During the insurance crisis of 1985-86, as during the crisis of 1975-76, supporters of limitations on liability argued that the tort system was causing insurance rates to rise.⁵ A substantial body of empirical evidence, however, demonstrates that there is no causal relationship between expanding (or contracting) tort law and rising (or falling) insurance rates.

For example, under contract with the U.S. Health Care Financing Administration, Vanderbilt University economics professor Frank Sloan studied the medical malpractice "reforms" enacted during the mid-1970s. During that time more than a dozen states limited medical malpractice liability, typically by capping noneconomic damages. Using regression analysis, Professor Sloan found that such limitations had no effect on insurance premiums.⁶

As Professor Sloan's study would suggest, the states that enacted substantial tort reform measures in the mid-1970s did not escape the insurance crisis of the mid-1980s. In 1978, Pennsylvania limited the liability of all municipalities to \$500,000 per occurrence and granted absolute immunity to municipalities in several classes of cases,⁷ thereby "stopping most claimants who otherwise have suffered legitimate injuries dead in their tracks."⁸ Nevertheless, Pennsylvania municipalities found it no easier to get insurance during the 1985-86 crisis than did municipalities in states where municipal liability is unlimited.⁹ Municipalities in other states had similar experiences.¹⁰

4. But see Lacey, *The Competitiveness of the Property-Casualty Insurance Industry: A Look at Market Equity Values and Premium Prices*, 5 YALE J. ON REG. 501 (1988) (discussion of profitability as inappropriate measure of insurance companies financial performance).

5. See, e.g., Aetna Casualty & Sur. Co., *Justice for All?*, Wall St. J., Jan. 23, 1987, at 21, col. 1 (advertisement); Insurance Information Inst., *No One is Immune From the Lawsuit Crisis*, Wash. Post, June 22, 1986, at 21, col. 1 (Magazine) (advertisement).

6. See Sloan, *State Responses to the Malpractice Insurance Crisis of the 1970's: An Empirical Assessment*, 9 J. OF HEALTH POL., POL'Y & L. 629-46 (1985).

7. Political Subdivision Tort Claim Act, 1978 Pa. Laws 1339, No. 330 (codified as amended at 42 PA. CONS. STAT. ANN. §§ 8501-8502, 8541-8542, 8545-8550, 8553, 8557-8559, 8563-8564 (Purdon 1982 & 1987 Supp.)).

8. See *Report, Recommendations, and Summary of Testimony: Hearing on Municipal Liability Insurance, Sept. 24, 1985, Before Pennsylvania Local Gov't Comm'n* 3-4 (Nov. 1985).

9. *Id.*

10. In 1976, New Mexico capped municipal liability at \$300,000 per person and \$500,000 per occurrence, Tort Claims Act, 1976 N.M. Laws 159 (codified as amended at N.M. STAT. ANN. § 41-4-19 (1976)) and it eliminated joint and several liability by court decision in 1982. *Bartlett v. New*

The continued escalation of rates and refusals to write in states that enacted tort reforms during the insurance crisis of the mid-1980s provides further evidence. For example, in April 1986, the Colorado legislature capped noneconomic damages, limited punitive damages, eliminated joint and several liability, and eliminated the collateral source rule.¹¹ Soon after the bill was enacted, the Hartford Insurance Company, one of the nation's largest insurers, announced that beginning in 1987 it would no longer write medical malpractice insurance in Colorado, leading Republican legislators to charge that "the insurance industry deceived the legislature when it pushed the reforms as dealing with the liability crisis."¹²

Moreover, in 1985-86 an insurance crisis occurred in some foreign jurisdictions which have much more restrictive tort laws than the United States. For example, liability in the Canadian province of Ontario is much more limited than liability in the United States. Damages for pain and suffering are capped at \$100,000 (in 1978 Canadian dollars),¹³ punitive damages are virtually unknown,¹⁴ contingency fees are prohibited,¹⁵ the losing party must pay the prevailing party's attorney's fees,¹⁶ and there is

Mexico Welding Supply, Inc., 98 N.M. 152, 646 P.2d 579 (Ct. App. 1982), *cert. denied*, 98 N.M. 336, 648 P.2d 794 (1982). Yet in 1985, New Mexico municipalities found it no easier to get insurance than did municipalities in states where municipal liability is unlimited and joint and several liability applies. See *Liability Claims Down, Insurance Premiums Up*, Roswell Daily Rec., May 15, 1986, at 1, col. 1.

Similarly, in 1983 the Iowa legislature substantially eliminated joint and several liability in order to prevent the doctrine from causing cities and counties to pay large liability claims. Municipal Tort Claims Act, 1983 Iowa Acts 70 (codified as amended at IOWA CODE ANN. § 613A.4 (West 1950 & 1988 Supp.)). Yet in 1985, 41 counties had their liability insurance cancelled within a 30 day period, leading former Iowa Senate Majority Leader Lowell Junkins, who had led the legislative fight to eliminate joint and several liability, to change his views and begin travelling around the country urging other state legislators not to make the same mistake. Interview with Lowell Junkins, former Iowa Senate Majority Leader, in Orlando, Fla., (Jan. 20, 1986).

11. Colorado Governmental Immunity Act, 1986 Colo. Sess. Laws 873 (codified as amended at COLO. REV. STAT. § 24-10-102 to -120 (1973 & 1987 Supp.)).

12. *Other News From the States*, LIABILITY WEEK, July 28, 1986, at 3. The insurance industry has been extraordinarily successful at influencing legislative behavior. Perhaps most strikingly, the West Virginia legislature passed a bill in March 1986, effective in June of the same year, that capped damages, required insurer data disclosure, and prohibited mid-term policy cancellations. In May, three West Virginia malpractice insurers, led by the nation's largest, St. Paul Fire and Marine, notified all West Virginia doctors that their insurance would be cancelled effective May 31. The companies claimed that the new law's insurance reform provisions were too onerous and its tort reform provisions too weak. The legislature therefore came back into special session and weakened the insurance reform provisions by requiring less financial disclosure, while strengthening the tort reform provisions by restricting joint and several liability. See Cain, *West Virginia Enacts Municipal Tort Reform Bill*, Bus. Ins., June 9, 1986, at 2, col. 3; *West Virginia Bill Signed Easing Curbs on Insurers*, Wall St. J., May 30, 1986, at 12, col. 3.

13. *Andrews v. Grand & Toy Alberta Ltd.*, 2 S.C.R. 229, 233 (1978); ONTARIO LAW REFORM COMM'N REPORT ON PRODUCTS LIABILITY 62 (1979) [hereinafter ONTARIO LAW REPORT].

14. See ONTARIO LAW REPORT, *supra* note 13, at 75; CANADIAN TORT LAW, 49-51 (A. Linden ed. 1977).

15. See ONTARIO LAW REPORT, *supra* note 13, at 72, 75.

16. *Id.* at 72, 76.

no constitutional right to a jury trial.¹⁷ Nevertheless, in 1985-86 insurers refused to insure day care centers, school bus operators, municipalities, and others in Ontario, just as they did in the United States.¹⁸

Perhaps the most compelling evidence that tort reform has not affected insurance rates comes from insurance companies themselves. For example, in 1986, Florida enacted what Aetna Casualty & Surety Co., the nation's third largest insurer, characterized as "full-fledged tort reform."¹⁹ Yet in connection with its request for a rate increase soon after the law was enacted, Aetna conducted a study concluding that the Florida tort reforms would have no effect on its rates.²⁰ Eliminating the collateral source rule, Aetna said, would have a negligible effect because "current Aetna claim settlement practices recognize, in part, the existence of collateral sources as part of the negotiating process used in arriving at a mutually satisfactory damage value with the plaintiff."²¹ Restricting joint and several liability would not reduce insurance rates "due to the interaction of economic damages sustained by the plaintiff, the percentage of liability assigned to Aetna's insured, and the policy limits purchased."²² Moreover, limiting compensation for "noneconomic" damages would not reduce insurance

17. *Id.* at 74, 102-04.

18. See 1 ONTARIO TASK FORCE ON INSURANCE, A PRE-PUBLICATION OF THE FINAL REPORT OF THE ONTARIO TASK FORCE ON INSURANCE TO THE MINISTER OF FINANCIAL INSTITUTIONS (1986). The Task Force found that a severe insurance crisis existed in Ontario even though "Ontario is not 'California North'. Our tort system is different. There is no need to restrain juries because juries are rarely used. There is no need to place legislative limits on pain and suffering awards because a \$100,000 ceiling was imposed judicially in 1973. There is no need to regulate contingent fees or reform class actions because these too do not exist." *Id.* at 77; see also R.A. Winter, *The Liability Crisis and the Dynamics of Competitive Insurance Markets*, 5 YALE J. ON REG. 455, 462 (1988) (discussing Canadian insurance crisis).

19. See Carpenter, *Big Business Pushing Tort Reform*, J. Com., Aug. 13, 1986, at 12A, col. 3.

20. On the basis of an analysis of 105 claims it had recently closed, Aetna estimated that the following tort reforms would have the following effects:

Impact of Tort Law Changes

Tort Law Change	Line of Business	
	Products Bodily Injury	All Other General Liability
Collateral Source Offset	0	(0.4%)
Joint and Several	0	0
Limitation of Noneconomic		
Damages to \$450,000	0	0
Punitive Damages	0	0
Future Economic Damages over		
\$250,000 Paid at Present Value	0	0

Aetna Casualty & Sur. Co., Commercial Ins. Div., Bodily Injury Claim Cost Impact of Florida Tort Law Change 1 (Aug. 8, 1986) (unpublished report on file with Fla. Ins. Dep't). For a further discussion of the medical malpractice insurance market in Florida, see Blair & Makar, *The Structure of Florida's Medical Malpractice Insurance Market: If It Ain't Broke, Don't Fix It*, 5 YALE J. ON REG. 427 (1988).

21. Aetna Casualty & Sur. Co., *supra* note 20, at 2.

22. *Id.*

costs, according to Aetna, "due to the impact of degree of disability on future losses, the impact of policy limits, and the actual settlement reached with the plaintiff."²³ Finally, limiting punitive damages would have "no impact" on Aetna's claims values,²⁴ and requiring periodic payments of future economic damages over \$250,000 would yield "no net savings," because of the "interaction of policy limits, past economic losses, and future economic losses," the "settlement value of the case," and the "apparent implicit recognition of the periodic nature of future damages."²⁵ Other insurers came to the same conclusions about the lack of a relationship between tort reform and availability.²⁶

In 1986, the State of Washington enacted perhaps the most comprehensive "tort reform" package in the nation, virtually eliminating joint and several liability, limiting damages for pain and suffering to between \$117,000 and \$570,000 (depending on the age of the plaintiff), and providing for periodic payment of future economic damages of more than \$100,000.²⁷ Nevertheless, in an April 23, 1986, letter to the Washington Insurance Department, the Great American West Company concluded that the new law would not reduce its insurance rates and might even raise them.²⁸ More recently, Great American West's chairman told an audience of insurance executives that tort reform "will not eliminate the market dynamics that lead to insurance cycles,"²⁹ and warned them that "we must not over-promise—or even imply—that insurance cycles will end when civil justice reform begins."³⁰

In short, tort reform does not reduce insurance rates. Even the insurance industry has abandoned the argument that expanding tort law caused

23. *Id.*

24. *Id.*

25. *Id.* at 3.

26. St. Paul Fire & Marine, for example, conducted an analysis like Aetna's and reached similar conclusions. St. Paul found that four of the 313 closed claims it analyzed would have been affected by the tort reforms enacted in Florida, "for a total effect of about 1% savings." St. Paul Fire & Marine Ins. Co., Medical Professional Liability, State of Florida—Addendum 1 (1986) (unpublished report on file with Fla. Ins. Dep't). St. Paul further explained that the one percent savings estimate probably overstated the effect of tort reform. *Id.*

Similarly, in October 1986, State Farm Fire & Casualty Co. wrote the Kansas Insurance Department that the same five tort reforms enacted in Florida would have a negligible effect on State Farm's rates. State Farm emphasized that "other factors can produce an opposite effect which could equal or outweigh any positive effect of tort reform." Letter from Robert J. Nagel, Assistant Vice Pres., State Filings Div. State Farm Fire and Casualty Co., to Ray Rathert, Kan. Ins. Dep't (Oct. 21, 1986) (on file with author).

27. Tort Reform Act, 1986 Wash. Laws ch. 305, §§ 301, 402, 801 (codified as amended at WASH. REV. CODE ANN. §§ 4.22.030-4.22.070, 4.56.250, 4.56.260 (1962 & 1988 Supp.)).

28. Letter from Kevin J. Kelley, Director of Actuarial, Great American West, Inc., to Norman Figon, Rate Analyst, Washington Ins. Dep't (Apr. 23, 1986) (on file with author).

29. *Don't Link Rates to Tort Reform, Insurance Executive Warns Peers*, LIABILITY WEEK, Jan. 19, 1988, at 1.

30. *Id.*

the insurance crisis of 1985–86.³¹ The authors' continued reliance on that argument is unconvincing.

II. The Effect of the McCarran-Ferguson Antitrust Exemption on Insurance Rates

The preceding Part tried to show that the state of tort law was not a substantial contributing factor to the dramatic insurance rate increases and refusals to write that occurred in 1985–86. This Part contends that the real culprit is the antitrust exemption enjoyed by the insurance industry.

The authors argue that property-casualty insurance is competitively structured, and that insurers therefore cannot possibly collude, regardless of the antitrust exemption permitting them to do so. But they do not examine the conduct of the industry to determine whether insurance companies have in fact been colluding. By examining the industry's conduct, this Part demonstrates first that collusion exists in the property-casualty insurance industry, and then that this collusion caused the crisis. It argues that the repeal of the antitrust exemption will eliminate, or at least ameliorate, future crises. Finally, this Part examines the profitability of property-casualty insurance as a whole and, more specifically, the profitability of the two types of insurance that rose so dramatically in price during the 1985–86 "crisis"—medical malpractice and general liability. While the authors are generally correct in concluding that the property-casualty industry is competitively structured, the supra-competitive profits that medical malpractice and general liability insurers consistently earn is further evidence that collusion has in fact occurred in those segments of the industry, and that repeal of the antitrust exemption is likely to reduce profits and prices in those segments of the industry to competitive levels.

A. Conduct of Property-Casualty Insurers

Although the McCarran-Ferguson antitrust exemption permits price fixing, market division, tying arrangements, and other anticompetitive activities in the insurance industry, it does not allow boycotts—collective refusals to write insurance at any price. The leading case is *St. Paul Fire & Marine Insurance Co. v. Barry*,³² in which the Supreme Court held that an agreement by four malpractice insurers not to write such insurance

31. *Insurers Shy Away From Linking Rates to Tort Crisis*, LIABILITY WEEK, Dec. 21, 1987, at 1.

32. 438 U.S. 531 (1978).

during the 1974-75 malpractice crisis fell within the boycott exception to McCarran-Ferguson and thus violated the Sherman Act.

Similarly, in April 1986, during the most recent crisis, the three major West Virginia malpractice insurers sent notices to all their policyholders cancelling their insurance, effective May 31, 1987, in an effort to pressure the legislature to repeal insurance disclosure legislation scheduled to take effect June 6. After the state attorney general filed suit for boycott, the court enjoined the cancellations.³³ In 1986, Colorado day care centers sued insurers, alleging boycotts.³⁴ In March 1988, eight state attorneys general filed the largest insurance industry boycott case ever against approximately thirty insurance industry defendants.³⁵ The plaintiffs charge that the 1985-86 insurance crisis was caused by an agreement among four major insurance companies, the Insurance Services Office (ISO), and the major international reinsurance companies not to write certain types of insurance at any price.³⁶ Among the documents cited in the complaint is one signed by more than forty-three reinsurers entitled "Non-Marine London Market Agreement 1987," in which the signatories agreed not to write pollution coverage.³⁷ At the same time, a separate boycott case was filed by the Texas Attorney General. Texas alleged that during the insurance crisis, Aetna and other major insurance companies had agreed not to write certain types of "politically sensitive" insurance in order to pressure state legislators to enact tort reform.³⁸ Finding a "smoking gun" agreement not to underwrite insurance, however, is rather unusual. Price fixing is the more common situation. Yet, because of the McCarran-Ferguson exemption, courts have been forced to dismiss cases involving either price

33. *West Virginia ex. rel. Brown v. St. Paul Fire & Marine Ins. Co.*, Civ. No. 86-C-1400, Kanawha Cty. Circ. Ct. (W. Va., filed Apr. 14, 1986); *see also supra* note 12 and accompanying text.

34. Pankratz, *Day Care Centers File Insurance Suit*, Denver Post, Jan. 17, 1986, at B1, col. 2.

35. *California v. Hartford Fire Ins. Co.*, Civ. 88-0981 WWS (N.D. Cal. filed Mar. 22, 1988); *New York v. Hartford Fire Ins. Co.*, Civ. 88-0983 WWS (N.D. Cal. filed on Mar. 22, 1988); *Massachusetts v. Hartford Fire Ins. Co.*, Civ. 88-0984 WWS (N.D. Cal. filed on Mar. 22, 1988); *Minnesota v. Hartford Fire Ins. Co.*, Civ. 88-0985 WWS (N.D. Cal. filed on Mar. 22, 1988); *West Virginia v. Hartford Fire Ins. Co.*, Civ. 88-0986 WWS (N.D. Cal. filed on Mar. 22, 1988); *Wisconsin v. Hartford Fire Ins. Co.*, Civ. 88-0987 WWS (N.D. Cal. filed on Mar. 22, 1988); *Alabama v. Hartford Fire Ins. Co.*, Civ. 88-0988 WWS (N.D. Cal. filed on Mar. 22, 1988); *Arizona v. Hartford Fire Ins. Co.*, Civ. 88-1009 WWS (N.D. Cal. filed on Mar. 23, 1988). These cases are pending in federal court in the Northern District of California. Status conference was to be held on June 24, 1988. Consolidation of the individual cases for discovery purposes is under discussion.

36. *See Eight States Sue U.S., British Insurers*, Wash. Post, Mar. 23, 1988, at B1, col. 5.

37. Complaint at 35, ¶ 107, *West Virginia v. Hartford Fire Ins. Co.*, Civ. 88-0986 WWS (N.D. Cal. filed Mar. 22, 1988).

38. Plaintiff's Original Petition at 33-6, *State v. Insurance Servs. Office, Inc.*, No. 439,089 (Tex. 53d Dist. filed Mar. 22, 1988).

fixing³⁹ or any other type of collusion falling short of a complete refusal to deal on any terms.⁴⁰

B. *The ISO Rate*

The most pervasive collusion in the property-casualty insurance industry is the promulgation of rates by industry-owned and industry-operated "rate bureaus." Until the mid-1960s, rate bureaus typically required each of their members to adhere to the rates that they promulgated.⁴¹ The rate bureau that issues workers compensation insurance rates, the National Council on Compensation Insurance, still substantially retains this "adherence" requirement.⁴² In contrast, the ISO, the rate bureau that promulgates general liability, automobile, and homeowners policy rates, no longer expressly requires its members to adhere to its rates. Instead the ISO issues "advisory" rates.⁴³ Absent the McCarran-Ferguson immunity, the issuance of these advisory rates would almost certainly be a per se violation of the Sherman Act. Courts have consistently prohibited trade associations from circulating "suggested" price lists,⁴⁴ even when the list serves only as a starting point for price determination,⁴⁵ or when no agreement to adhere to the "suggested" price exists and prices do substantially depart from the "suggested" rate.⁴⁶ The ISO determines the prospective advisory rate by collecting and compiling past cost data on companies' payments of claims or amounts reserved for reported claims. Past

39. See, e.g., *Schwartz v. Commonwealth Land Title Ins. Co.*, 374 F. Supp. 564 (E.D. Pa. 1974); *Steingart v. Equitable Life Assurance Soc'y*, 366 F.Supp. 790 (S.D.N.Y. 1973); *Ohio AFL-CIO v. Insurance Rating Bd.*, 451 F.2d 1178 (6th Cir. 1971); *Fleming v. Travelers Indem. Co.*, 324 F.Supp. 1404 (D. Mass. 1971); *SEC v. National Sec.* 393 U.S. 453 (1969); *California League of Indep. Ins. Producers v. Aetna Casualty & Sur. Co.*, 175 F. Supp. 857 (N.D. Cal. 1959).

40. See, e.g., *Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419 (4th Cir. 1984) (redlining); *Dexter v. Equitable Life Assurance Soc'y*, 527 F.2d 233 (2d Cir. 1975) (tying arrangement); *Lawyers Title Co. v. St. Paul Title Ins. Corp.*, 526 F.2d 795 (8th Cir. 1975) (predatory pricing); *Grant v. Erie Ins. Exch.*, 542 F. Supp. 457 (M.D. Pa. 1982) (conspiracy to deny benefits).

41. NATIONAL ASS'N OF INS. COMM'RS, RATES AND RATING ORGANIZATIONS (F1), SUBCOMM. REPORT, Dec. 2 1968, at 4-5, *quoted in* STATE OF N.Y. INS. DEP'T, THE PUBLIC INTEREST NOW IN PROPERTY AND LIABILITY INSURANCE REGULATION, REPORT TO GOVERNOR ROCKEFELLER, 137 (Jan. 7, 1969) ("The requirement that member companies of Bureaus must adhere to bureau rates is being relaxed; member companies can treat the rates as advisory and may deviate from them without permission.").

42. National Council on Compensation Insurance, Const. art. VII, § (3)(c) (1985) (on file with author).

43. For an explanation of the use of advisory rates from an insurance industry perspective, see Lefkin, *Shattering Some Myths on the Insurance Liability Crisis: A Comment on the Article by Clarke, Warren-Boulton, Smith, and Simon*, 5 YALE J. ON REG. 417, 419-20 (1988).

44. *Northern Cal. Pharmaceutical Ass'n v. United States*, 306 F.2d 379 (9th Cir.), *cert. denied*, 371 U.S. 862 (1962).

45. *Plymouth Dealers Ass'n v. United States*, 279 F.2d 128 (9th Cir. 1960).

46. *United States v. Nationwide Trailer Rental Sys.*, 156 F. Supp. 800 (D. Kan.), *aff'd per curiam*, 355 U.S. 10 (1957); see generally U.S. DEP'T OF JUSTICE, THE PRICING AND MARKETING OF INSURANCE 167-70 (1977).

cost data must then be “developed” and “trended” through the application of a “loss development factor” and a “trend factor.” Advisory rates are based on “incurred losses,” estimates of the amount an insurer will eventually pay out on policies in effect in a given year. The estimates are calculated by multiplying the amount that has actually been paid out and reserved over a certain period for claims covered by these policies by the “loss development” factor. The loss development factor is based on the pattern of payouts over time on prior years’ policies. In determining the rates to be charged in future years, the ISO multiplies the developed incurred loss estimates for past years (actual payouts and reserves for a certain period times the loss development factor) by a “trend factor.” The trend factor is an estimate of such effects as (a) monetary inflation, (b) “social inflation,” (c) increases in the size of jury verdict amounts, and (d) increases in the rate of case filings. By using the ISO’s judgment with respect to these factors instead of each individual insurance company’s, the current McCarran-Ferguson-protected rate making regime remains anticompetitive.⁴⁷ Moreover, in order to arrive at a fixed “advisory” rate, the ISO supplements the developed and trended loss data with additional amounts for “loss adjustment expenses” (mainly legal defense fees), “total production cost allowance” (agents’ commissions and expenses), “general expenses,” “taxes, licenses, and fees,” and “underwriting profit and contingencies.”⁴⁸ Only forty percent of the ISO advisory product liability rate is actually paid in indemnity; fourteen percent goes for defense lawyers’ fees and other loss adjustment expenses,⁴⁹ twenty-five percent goes for “total production cost allowance,” thirteen percent goes for general expenses, three percent for taxes, licenses and fees, and five percent for underwriting profit and contingencies.⁵⁰

Most companies, however, have substantially lower expenses than those included in the ISO “advisory” rate.⁵¹ Thus, by issuing an “advisory”

47. For a more detailed explanation of the loss development and trend process, see U.S. DEP’T OF COMMERCE TASK FORCE ON PROD. LIAB. & ACCIDENT COMPENSATION, REPORT ON PRODUCT LIABILITY INSURANCE RATEMAKING 100 (1980).

48. See, e.g., INSURANCE SERVS. OFFICE, INC., Ohio Dep’t of Ins. Filing GL86 TPRD1 at Section D, Exhibit 5 (Feb. 21, 1986).

49. Fifty-four cents of each product liability premium dollar is allocated to loss and loss adjustment expense. In 1984, insurers allocated 36 cents for legal defense expenses for each dollar they paid or reserved in indemnity, up from 25 cents in 1970. Of the 54 cents of the product liability premium dollar allocated to loss and loss adjustment expense, therefore, 40 cents ($54 \div 1.36$) is paid to injured people and 14 cents is paid to defense lawyers and for other loss adjustment expenses. INSURANCE SERVS. OFFICE, INC., THE RISING COSTS OF GENERAL LIABILITY LEGAL DEFENSE, 2 (1986).

50. See U.S. DEP’T OF COMMERCE TASK FORCE ON PROD. LIAB. & ACCIDENT COMPENSATION, *supra* note 47.

51. Compare ISO Medical Malpractice Filing No. GL-87-BHOSI at Exhibit 3 (Dec. 22, 1987) with A.M. BEST CO., BEST’S AGGREGATES AND AVERAGES: PROPERTY-CASUALTY 153 (1987) (ISO allocates 15% of premium dollar to total production cost allowance while actual industry-wide average

rate that includes expense factors based on those of the least efficient insurers and a profit factor which, among other things, ignores investment income, the ISO both protects inefficient carriers and enables the more efficient carriers to earn supra-competitive profits.

In summary, the ISO not only develops and trends loss data, but further adds to this loss data figure allowances for various expenses, profits, and "contingencies." Rather than develop their own loss data figures, individual companies use the figures provided by the ISO and are thereby not genuinely competing. Accordingly the insurance market is not a free market. As the Supreme Court stated, "[g]enuine competitors . . . do not submit the details of their business to the analysis of an expert, jointly employed, and obtain from him a 'harmonized' estimate of the market as it is and as, in his specially and confidentially informed judgment, it promises to be."⁵² Absent the McCarran-Ferguson exemption, both the individual "competitors" engaging in such an outside analysis and the expert executing it, the ISO, would be in violation of the antitrust laws.

III. How the Protected ISO Rate Causes Periodic Insurance Crises

The ISO rate is largely responsible for the cyclical nature of the insurance industry,⁵³ and in particular for periodic insurance crises like the one that occurred in 1985-86. To be sure, fluctuations in interest rates, stock prices, and exchange rates, and the inelasticity of demand for insurance, have contributed to the cycle.⁵⁴ But it is the industry's antitrust exemption that makes the peaks and valleys so extreme. The most apparent effect of McCarran-Ferguson is the sudden, dramatic increase in insurance rates that occurs at the bottom of each cycle. In January 1985, the ISO apparently decided that the price cutting of the last few years had gone far enough; ISO President Daniel McNamara called a joint industry conference with the Insurance Information Institute, the industry's public relations arm, where he emphasized that "the need for significant premium

is 6.4%, sum of ratios to premium written in categories of "commissions and brokerage incurred" and "other acquisitions incurred").

52. American Column & Lumber Co. v. United States, 257 U.S. 377, 410 (1921).

53. Many insurance executives see the insurance cycle as inevitable. *Property-Casualty Executives Speak Out*, BEST'S REV.: PROPERTY/CASUALTY INS. EDITION, July 1985, at 18. For example, Aetna's President, William O. Bailey, observed that "the cyclical nature that is ingrained in the business will not disappear." *Id.* U.S.F. & G.'s President, Paul Scheel, believed that "the property-casualty industry always will be cyclical." *Id.* at 22. Cincinnati Insurance Co.'s President, Robert B. Morgan, concluded that "[t]here is not a chance that underwriting stability—over a period of years—is feasible." *Id.* at 19.

During the 50 years prior to 1984, insurance cycles have lasted from four to 11 years. *Wall Street Analyst's Report Disputes Consumerist Allegations*, BEST'S INS. MGMT. REP., Release No. 29, Aug. 11, 1986, at 1. (Statement of Salomon Brothers Managing Director Michael Frinquelli).

54. *Id.*

increases, especially for commercial lines, is absolute for the next three years.”⁵⁵ Then, in May 1985, the ISO distributed throughout the industry a major position paper, entitled *1985: A Critical Year*, which proclaimed that “the brutal price war of the last six years is over,” and that “significant premium increases are needed, especially for the current commercial lines products.”⁵⁶ Suddenly, in the summer of 1985, insurance companies that only a few months earlier had been competing on price and ignoring the ISO “advisory” rate were tripling and quadrupling their premiums, returning to the ISO rate.⁵⁷ Yet equally important is the effect of McCarran-Ferguson on insurance company pricing at the peaks of the insurance cycle. Since insurance companies know that McCarran-Ferguson allows them to get together to halt price cutting and suddenly raise their prices in concert, they engage in price cutting during periods of high interest rates. Thus McCarran-Ferguson allows them to get back in one year what they gave away in six.⁵⁸

The children’s game of tag provides an instructive analogy. The McCarran-protected bureau rate functions as “home base.” During the competitive phase of the cycle, insurers’ price cuts are deeper and the duration of their price cutting longer than would be the case in a free market because the price cutters know they can always return to the home base of the bureau rate. Because the rate is set at a level at which the least efficient bureau member is profitable, it allows most insurers to earn excess profits. These excess profits attract significant capital, which sets the stage for the price-cutting to begin again.

The existence of the ISO “advisory” rate also leads companies to monitor their costs inadequately. Rather than set their prices on the basis of their own costs and a reasonable profit, they use the ISO rate as a benchmark—even though each individual insurer has a mix of business different from that of the average insurer, so that each insurer’s loss experience and payout patterns differ from the average. If the ISO were prohibited from issuing an advisory rate—if there were no benchmark—companies would be forced to monitor their costs more carefully and to set their prices on the basis of those costs. As long as the ISO issues an “advisory”

55. Bradford, *Property/Casualty Shortfall May Total \$62 Billion Over Three Years, ISO Says*, *Bus. Ins.*, Feb. 4, 1985, at 16, col. 2.

56. INSURANCE SERVS. OFFICE & NAT’L ASS’N OF INDEP. INSURERS, *1985: A CRITICAL YEAR* 5 (1985).

57. Bingman, *Special Risks and 1985-1986 Market Capacity*, *National Underwriter*, Sept. 6, 1985, at 82, col. 1 (“[T]he quick reversal in underwriting standards has been shocking . . . [In the area of general liability, w]hat has occurred however, is a return to basic ISO rating subject to a minimum 20% surcharge.”).

58. *But see* R.A. Winter, *supra* note 18, at 497-98 (prohibition against information sharing would exacerbate problems, making market more cyclical and forcing smaller firms out of market).

rate, the effect of mistakes in judgment about loss development or trend factors, or of deliberate attempts to inflate losses to pressure legislatures to enact tort reform, is magnified. In contrast, as an independent actuary recently explained to the House Judiciary Committee, "[w]ith the elimination of Bureau rates as a standard, companies would develop their own rate structure. These rates may not all necessarily move in the same direction, depending on each individual company's book of business. Thus, rate 'swings' would tend to be ameliorated."⁵⁹

IV. The Profitability of Property-Casualty Insurance Markets

Property-casualty insurance is divided into "lines," subcategories of lines called "sublines," and subcategories of sublines called "classes." For example, general liability is a line and is made up of three sublines: products and completed operations liability; manufacturers' and contractors' liability; and owners', landlords', and tenants' liability. Each of these sublines is made up of hundreds of classes—such as day nursery liability, sporting goods manufacturing, and pharmaceutical manufacturing.⁶⁰ These categories are established by the ISO. The kinds of insurance for which insurers sharply raised prices in 1985–86, such as liquor liability, recreational liability, and political subdivision liability, typically include several different classes as defined by the ISO.⁶¹

Measuring the true profitability of both property-casualty insurance in general and of specific categories of property-casualty insurance is difficult for two reasons. First, property-casualty insurance companies do not use generally accepted accounting principles (GAAP); instead, they use more conservative accounting principles adopted by the National Association of Insurance Commissioners (so-called statutory accounting principles).⁶² These principles consistently understate profitability in two ways. First, statutory accounting principles allow a company to deduct immediately the full amount it estimates it will pay out on policies currently in effect, even if those payments will not actually be made for many years, thereby ignoring the time value of money. Second, statutory accounting principles allow insurers to deduct immediately business expenses associated with

59. BEST'S INS. MGMT. REP., Release No. 43, Dec. 14, 1987; *Hearings Before the House Judiciary Comm., Subcomm. on Monopolies and Commercial Law* 100th Cong., 2d Sess. (1987) (unpublished) (Statement of James S. Stergiou).

60. See, e.g., INSURANCE SERVS. OFFICE, INC., COMMERCIAL STATISTICAL PLAN—PRODUCTS/COMPLETED OPERATIONS LIABILITY PRODUCT CLASSIFICATION CODES, 176–187.2 (list of hundreds of classifications, from "Abrasive Paper or Cloth Preparation" (code 32908) to "Zinc Products Mfg." (code 34904)).

61. See ISO REPORT, *supra* note 1.

62. See U.S. GEN. ACCOUNTING OFFICE, CONGRESS SHOULD CONSIDER CHANGING FEDERAL INCOME TAXATION OF THE PROPERTY-CASUALTY INSURANCE INDUSTRY iii (1985).

the sale and renewal of insurance policies regardless of the life of the policy, rather than requiring allocation of those expenses to match the associated premium revenues. These two conventions substantially understate profitability.⁶³

The second difficulty in measuring property-casualty industry profitability is the impossibility of determining at the time policies are written the amount that will ultimately be paid out on those policies. The ultimate payout must therefore be estimated. Even using the most up-to-date methods and assuming the utmost good faith on the part of insurers, these estimates are necessarily inaccurate and have proved in the past to be substantially overstated, thus understating profitability. A 1986 study, for example, calculated that the one hundred largest property-casualty insurance companies had on average overestimated the amount they would pay on policies in force in 1984 by twenty-one percent.⁶⁴ Of course, if insurers make their estimates in less than good faith—if, for example, they deliberately inflate their reserves in connection with their campaign for tort reform—these estimates are even more likely to be inaccurate.⁶⁵ In July 1987, the U.S. General Accounting Office studied the profitability of medical malpractice and general liability insurance and found that if the time value of money is taken into account, insurers earned a return on premiums of 15.3%, which, based on the standard 2:1 premium-to-surplus ratio, translates into a rate of return on surplus of 30.6%.⁶⁶ Similarly, the GAO

63. *Id.*; see also Lacey, *supra* note 4, at 504-05.

64. BEST'S INS. MGMT. REP., Release No. 15, Apr. 7, 1986.

65. The authors measure changes over time, not in the amount insurers actually pay out on a given year's policies, but rather changes over time in the amount insurers estimate that they will eventually pay out on a given year's policies. They conclude, quite accurately, that insurers' estimates of how much they will pay out in the future were higher during the period 1981-85 than they were in the period 1967-80. The increase in estimates of future payouts could mean, as the authors hypothesize, that actual payouts have increased. On the other hand, it could also mean that insurers are deliberately inflating their estimates to support their campaign for tort reform. While the authors prefer the first explanation, they offer us no reason to choose it over the second one.

Similarly, the authors correctly conclude that insurers' estimates of future payouts were more variable in the period 1981-85 than in the period 1967-80. They hypothesize that greater variability during the period 1981-85 means that tort law had become more uncertain during that period. On the other hand, it can also mean that insurers are deliberately manipulating their reserves—for example, increasing their reserves in order to bolster their campaign for tort reform, or reducing them in order to increase their surplus. Because the greater the industry's surplus, the more premium it can write, insurers have an incentive to understate their reserves when interest rates are high, and thus to characterize more of their money as surplus and write more premiums which can then be invested at high interest rates.

That incentive is particularly strong with respect to the so-called "long-tail" lines, such as general liability and medical malpractice, where a large percentage of claims are not paid until many years after the premium has been paid, during which time the premium is invested. We would therefore expect loss ratios for these lines to be highly variable—to be higher when interest rates are high, yielding sufficient investment income to offset a substantial underwriting loss, and lower when interest rates and investment income is low, and thus unable to offset a substantial underwriting loss.

66. U.S. GEN. ACCOUNTING OFFICE, INSURANCE: PROFITABILITY OF THE MEDICAL MALPRACTICE AND GENERAL LIABILITY LINES 25 (1987). The funds insurance companies hold in addition to

found that insurers earned 13.4% on premiums on general liability insurance, which translates into a 26.8% return on surplus.⁶⁷ During the same eleven year period the all-industry average rate of return on net worth was 13.2%.⁶⁸ Thus, both general liability insurers and medical malpractice insurers have earned returns of more than 200% of the all-industry average over the last decade.⁶⁹ In 1986 and 1987, medical malpractice and general liability insurers continued to do well. In 1987, for example, medical malpractice insurers had their most profitable year since 1979, and their estimates of how much they would pay out in the future, their so-called "incurred losses," increased by only 1.2%, while loss adjustment expenses, mostly defense lawyers' fees, actually decreased by 1.6%.⁷⁰ According to Best's, the reporting service for the property-casualty industry, "the outgo factors have stabilized at almost a no-growth level "for medical malpractice insurance" and "the stabilizing trend of losses and expenses bodes well for this line in the future."⁷¹ Similarly, in both 1986 and 1987 general liability insurers were more profitable than they had been in any year since 1980.⁷²

Insurers who write certain subcategories of general liability insurance have also been consistently earning excessive profits in recent years. Although insurers have not traditionally been required to disclose their premiums and losses for such subcategories, in 1986 and 1987 several states enacted statutes requiring such disclosure.⁷³ In the states for which data are available, the loss ratios for both day care liability and liquor liability

the amount they estimate they will pay out in future claims are called surplus. Although they invest both the funds they have received to pay future claims and the funds they hold as surplus, they carry the former on their books as a liability, as so-called "loss reserves." Surplus, in contrast, is an asset and corresponds to net worth in other industries. Insurers typically write two dollars of premium for each dollar they hold in surplus. BEST's INS. MGMT. REP., Release No. 30, Oct. 13, 1986, at 3. An insurer's return on surplus—in effect, its return on net worth—is therefore approximately double its return on premium.

67. *Id.* at 30.

68. INSURANCE INFORMATION INST., INSURANCE FACTS: 1986-87 PROPERTY-CASUALTY FACT BOOK 22 (1988); INSURANCE INFORMATION INST., INSURANCE FACTS: 1985-86 PROPERTY-CASUALTY FACT BOOK 22 (1987).

69. Property-casualty insurers also far outperformed the general stock market during the late 1970s and early 1980s. For example, on December 31, 1977 Best's property-casualty stock index stood at 156.10, compared to 624.33 on December 31, 1985, for a gain of 300%. During the same period, the Dow Jones Industrial Average rose by 86%, from 831.17 to 1546.67. BEST's INS. MGMT. REP., Release No. 3, Jan. 25, 1988. Thus, property-casualty stocks rose more than three times as much as the stock market as a whole.

70. BEST's INS. MGMT. REP., *supra* note 1, at 10.

71. *Id.*

72. *Id.* at 8-9.

73. In 1986, 18 states enacted statutes requiring insurance companies to disclose previously undisclosed data. Most statutes called for the disclosure of premium and losses on several subcategories of general liability insurance, typically including day care liability. See STATISTICAL INFORMATION ADVISORY COMMITTEE TO THE NAIC LEGAL LIABILITY INSURANCE (D) TASK FORCE, app. B at i (Dec. 1986).

are consistently well under 100% and have declined over time, demonstrating that those types of insurance are extremely profitable and have become more profitable over time.⁷⁴ The question then arises: if medical malpractice and general liability insurance are so profitable, then why are new companies not entering those markets and bidding away those profits? The authors are generally correct in concluding that the property-casualty industry is structured competitively, and that it would be a relatively simple matter for any insurance company writing any type of property-casualty insurance to write any other type of property-casualty insurance. To be sure, an insurer must meet the capital and surplus requirements of each state in which it wishes to do business, and somewhat different knowledge may be necessary to write medical malpractice, for example, than to write pollution liability. Yet the capital and surplus requirements of the different states are relatively nominal,⁷⁵ and the specialized expertise which insurers say they possess seems more illusory than real.⁷⁶

On the other hand, significant entry barriers have traditionally kept the two most likely potential entrants out of the insurance business: banks and insureds. Both federal and state laws, for example, continue to prevent banks and other financial institutions from entering insurance.⁷⁷ And groups of commercial risks who wish to band together to set up their own insurance company have traditionally been prohibited from doing so since they have had to comply with the multiple, and often conflicting, capital, surplus, and other legal requirements of each state in which any group

74. For example, the loss ratios for day care liability in New York were 0.657 in 1981, 0.377 in 1982, 0.554 in 1983, 0.690 in 1984, and 0.394 in 1985, based on the data insurers submitted pursuant to New York's new disclosure statute. STATE OF N.Y. INS. DEP'T, ANNUAL COMMERCIAL PROPERTY-CASUALTY REPORT 14, 36 (Jan. 1, 1988). It is important to keep in mind that a loss ratio of 0.394 in 1985 does not mean that insurers pay out 39 cents in 1985 for each dollar they receive in premiums that year, but rather that they estimate they will eventually pay out 39 cents for each dollar they earn in premiums in 1985. Between 1985 and the time they eventually pay the claims, which for day care is typically between three and five years, the premiums they have received earned interest. The loss ratio is calculated by dividing incurred losses by earned premium. Because the loss ratio does not include investment income, an insurer can have a loss ratio of over 100%, particularly in the long-tail line, and still be highly profitable. *Id.* at 33. In addition, their 39 cent estimate is likely to be inaccurate and, according to Best's, likely to be overstated. Insurance yielding a .394 loss ratio is therefore extraordinarily profitable.

75. Capital and surplus requirements can be as low as \$400,000. See INSURANCE INFORMATION INST., BASIC CONCEPTS OF ACCOUNTING AND TAXATION OF PROPERTY-CASUALTY INSURANCE COMPANIES 33 (1984) (citing capital and surplus requirements in Pennsylvania); see also Blair & Makar, *supra* note 20, at 442-46 (arguing that insurance companies can easily change the liabilities they insure).

76. See *St. Paul's Heresy*, INSTITUTIONAL INVESTOR, Nov. 1987, at 151-53; *Property-Casualty Executives Speak Out*, *supra* note 53.

77. See *Banks as Insurance Agencies: Legal Constraints and Competitive Advances*, NEW ENGLAND ECON. REV. Sept./Oct. 1985, at 34.

member is located.⁷⁸ In October 1986, however, Congress enacted the Liability Risk Retention Act of 1986, which enables commercial risks to form their own insurance companies, called risk retention groups, by complying only with the legal requirements of the state in which the group was licensed.⁷⁹ This reform has made the formation of such groups significantly easier. The state insurance commissioners, however, have been hostile toward the groups; commissioners have sought to shut groups down that do business in their states without state licenses.⁸⁰ The full procompetitive effects of the groups, therefore, have yet to be realized.

In addition, the premium-to-surplus ratio makes it necessary for insurers to have substantially more cash surplus than what is expressly required by state law in order to expand into additional lines. Moreover, when insurers sharply raise their prices the 2:1 premium-to-surplus ratio prevents them from writing as much insurance as consumers demand. This artificial restriction of supply forces prices even higher. Assume, for example, that in 1984 insurer A, writing at a 2:1 premium-to-surplus ratio, has \$100 in surplus and insures two risks for \$100 each. He then doubles his rates, so that he now must charge each of those two risks \$200 for the same coverage. However, in order to maintain a 2:1 premium-to-surplus ratio he must drop one of the risks—even if it is profitable.

Perhaps the biggest reason for the absence of new entries during the 1985–86 crisis, however, is what the Insurance Information Institute (III) trumpeted as its “effort to market the idea that there is something wrong with the civil justice system in the United States,” which it launched in December 1984.⁸¹ Pursuant to this effort, insurance company and trade association executives encouraged others in the industry to refrain from writing certain types of insurance—whether or not they were profitable—in order to pressure legislatures to enact tort reform.⁸² In June 1985, for example, former GEICO Chairman John J. Byrne told the Casualty Actuaries of New York that they should quit covering doctors, chemical

78. See S. REP. NO. 294, 99th Cong., 2d Sess. 3 (1986); H.R. REP. NO. 865, 99th Cong., 2d Sess. 8-9 (1986); H.R. REP. NO. 190, 97th Cong., 1st Sess. 4-7 (1981).

79. Pub. L. No. 99-563, 100 Stat. 5177 (1986) (codified as amended at 15 U.S.C. §§ 3901-3903, 3905, 3906 (Supp. 1986)).

80. See, e.g., Geisel, *Risk Retention Group Says Kentucky Violated 1986 Act*, Bus. Ins., Feb. 29, 1988, at 2, col. 2. (“‘AIF is being denied the right to furnish a form of insurance coverage in Kentucky simply because it is a risk retention group,’ American Interfidelity Exchange’s complaint alleges.”); U.S. DEP’T OF COMMERCE, LIABILITY RISK RETENTION ACT OF 1986: IMPLEMENTATION REPORT (Sept. 1987); *Give It A Chance*, National Underwriter, Nov. 9, 1987, at 22, col. 2 (editorial citing state insurance commissioners’ hostility to risk retention groups).

81. Maher, *I.I.I. Launches New Ad Campaign*, National Underwriter, Dec. 21, 1984, at 2, col. 1.

82. *Accord State v. Insurance Servs. Office, Inc.*, No. 439,089 (Tex. 53d Dist. filed Mar. 22, 1988); see also *West Virginia v. Hartford Fire Ins. Co.*, Civ. 88-0986 WWS (N.D. Cal. filed Mar. 22, 1988); *Eight States Sue U.S., British Insurers*, *supra* note 36 (article citing case).

manufacturers, and corporate officers and directors since “[i]t is right for the industry to withdraw and let the pressure for reform build in the courts and in the state legislatures.”⁸³

A few months later, in November 1985, the III sent a “kit” on the “civil justice crisis” to insurance executives and agents urging them to tell their policyholders and the media that “insurers have no recourse but to cut back on liability insurance until improvements in the civil justice system will create a fairer distribution of liability, reduce the number of lawsuits, and create a climate in which insurance can operate more predictably.”⁸⁴ Then, in January 1986, the III announced a new \$6.5 million television and magazine advertisement campaign targeted at twelve states in which it was seeking tort reform designed, in the III’s words, “to change the widely held perception that there is an ‘insurance crisis’ to a perception of a ‘lawsuit crisis’.”⁸⁵ The advertisements featured polio victims, mothers, ministers, and high school athletes explaining that “doctors are afraid to deliver babies, clergy are becoming reluctant to counsel their congregations, and high schools are thinking about closing down their sports programs” because of the “lawsuit crisis.”⁸⁶ The magazine advertisements ran in the New York Times and the Washington Post,⁸⁷ among other newspapers. NBC, the only network to run the advertisements, insisted that they be substantially changed after a citizen group charged that they were deceptive.⁸⁸ Individual insurance companies and insurance brokerages also ran their own advertisements carrying similar messages.⁸⁹

In short, with the III and the ISO campaigning for tort reform on the grounds that the dramatic increases of 1985–86 in general liability and medical malpractice rates were the result of a “lawsuit crisis,” it would hardly add to the insurance industry’s credibility if incumbent insurance companies were suddenly to begin writing medical malpractice or general liability insurance in the midst of that crisis. That would seem to be the most important reason incumbent insurers did not begin writing the his-

83. J. Com., June 18, 1985, at 10A, col. 1.

84. INSURANCE INFORMATION INST., OUTLINE FOR SPEECH: CRISIS IN THE CIVIL JUSTICE SYSTEM 7 (Nov. 11, 1985) (attachment to Memorandum from Mechlin D. Moore, President, Insurance Information Institute, to State Presidents and Senior Staff Executives of the Professional Insurance Agents).

85. *Tort Reform Drive Launched*, J. Com., March 19, 1986, at 1, col. 2.

86. See *id.*; Aetna Casualty & Sur. Co., *supra* note 5.

87. See *supra* note 5.

88. See Howard, *NBC Decides Not to Air I.I.I. Tort Reform Ads Pending Further Review*, National Underwriter, Apr. 11, 1986, at 1, col. 3; see also *Tort Reform Drive Launched*, J. Com., Mar. 19, 1986, at 1, col. 2.

89. See American International Group, *There's a Price to Be Paid for Excessive Liability Awards in Our Courts*, Wash. Post, Dec. 17, 1985, at A16, col. 1.

torically profitable general liability and medical malpractice lines during the most recent trough in the insurance cycle.

Conclusion

While the authors theorize that changes in tort law caused insurance rates to skyrocket and insurers to withdraw from certain markets, the empirical evidence rebuts their view. The insurance industry itself has published studies demonstrating that limitations on liability will not reduce insurance rates. For the authors to claim that expanding tort liability has raised insurance rates is unconvincing.

The authors' insistence on the benign nature of the McCarran-Ferguson Act, which permits insurers to fix prices and engage in other anticompetitive practices that would be punishable in any other industry by three years imprisonment and a one million dollar fine, is also quite troublesome. While there is disagreement in antitrust circles about the proper scope of the antitrust laws, there has heretofore been unanimous agreement that horizontal restraints, such as price fixing, harm consumers, and exemptions from the antitrust laws are unjustifiable for any industry.

The authors fail to come to grips not only with the evidence of collusion established in the records of antitrust cases filed during the two most recent insurance crises, but also with the protected anticompetitive activities in which the insurer-owned and insurer-operated Insurance Services Office has long engaged. The ISO is legally permitted to issue "advisory rates" on behalf of the industry. Yet, since these advisory rates are based on the costs of the least efficient carriers and on the ISO's judgment as to the extent to which claims are likely to escalate in the future, an overestimate by the ISO—innocent or otherwise—as to the level of future claims can sharply and unjustly raise insurance prices across the industry.

The authors have also chosen to ignore the extraordinary public relations campaign mounted by the insurance industry to "market the idea that there is something wrong with the civil justice system in the United States," as the III puts it.⁹⁰ The industry has a right, of course, to seek to manipulate public opinion in any way it desires, at any cost it can afford, by any legal means. No sound analysis of the recent insurance crisis, however, can disregard that manipulation.

Finally, the authors do not acknowledge the long-term profitability of general liability and medical malpractice insurance, as documented by the GAO, and the unprecedented profitability of the property-casualty indus-

90. See Maher *supra* note 81.

try in 1986–87. The collusive benefits granted to the insurance industry by the McCarran-Ferguson exemption help to explain both the long-term profitability of the industry and the record profitability of the industry following the “crisis” years of 1984 and 1985. The state of tort law does not.

